25X1

Approved For Release 2007/03/09 : CIA-RDP85T00875R001700050053-7

Confidential

25X1

DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

Problems in Indo-US Economic Relations

Confidential

ER IM 73-56
September 1973

Copy No. 60

25X1

Approved For Release 2007/03/09 : CIA-RDP85T00875R001700050053-7

[redacted]

25X1

September 1973

Problems in Indo-US Economic Relations

The United States is exploring the possibilities for a new economic relationship with India that would involve increased private foreign investment and expanded US exports. The prospects for the near term are not bright, however. Massive US economic aid, which provided the basis for the high levels of activity in the 1960s, has ended, and the US presence in India has been sharply reduced. The present economic climate is controlled by:

- India's hostile attitude toward private foreign investment.
- India's administrative barriers to US exports.
- US intention to reduce multilateral aid as well as bilateral aid to India, which will limit US exporters' ability to provide competitive long-term financing.

Over the longer term, expanded economic relations will depend principally on New Delhi's policies. India needs sophisticated machinery, advanced technology, and food grains. The United States is the only nation that can offer the large volume and variety of the goods needed by India. India, however, remains an invalid in world trade, producing for marginal markets and accepting whatever aid the world will offer. There has been little indication that India intends changing this posture.

25X1

25X1

Note: Comments and queries regarding this memorandum are welcomed. They may be directed to [redacted]

Approved For Release 2007/03/09 : CIA-RDP85T00875R001700050053-7

25X1

DISCUSSION

Introduction

1. The United States has been reviewing its economic policies toward India since December 1971, when US aid was suspended. Both sides have taken steps to move away from a donor/patron relationship. Economic relations had previously been based essentially on a massive US aid program. US economic aid of about $9 billion since India's independence made up about 50% of all aid provided India. This memorandum evaluates the major problems generated by the US aid program and examines opportunities for, and obstacles to, improved economic relations between the United States and India.

2. Throughout the 1960s, US economic aid to India provided the basis for good economic relations. US aid supported American firms in India, helped finance new US private investment, and financed a substantial part of US exports. The United States, however, consistently had a trade deficit with India on its commercial trade accounts. Economic relations deteriorated markedly when the United States halted economic aid in December 1971. US exports to India declined sharply, and US firms in India had trouble financing needed imports from the United States. US aid-financed rupee loans to US firms in India were halted. No new US aid has been provided India since the cut-off, and economic relations remain at a low ebb.

Problems Generated by US Aid

High US Profile

3. The most visible consequence of the US aid program, and probably the most objectionable to India, was the large US presence. At one time or another during the 1960s, US personnel included a 150-man military mission, about 300 AID technicians, 1,200 Peace Corps volunteers, more than 600 American students and professors funded by the US Government, large numbers of personnel from USIS and other US agencies, and a number from voluntary agencies and private foundations. A $3 million AID housing complex completed in 1969 made the large US personnel presence even more visible and objectionable.

4. New Delhi became especially agitated about the size and scope of American activities after Washington halted economic aid in December 1971. The US presence has since been sharply reduced by New Delhi's withholding approval for replacement of individuals returning to the United

States. No new joint research projects between US agencies and Indian scientific and academic institutions or new agricultural research service grants have been approved since mid-1972. By mid-1973, only 12 AID personnel were in India, and Washington had agreed to end all technical assistance programs and to give India the AID housing complex.

5. By March 1973 the US aid program had generated a $3.3 billion debt, about one-third of New Delhi's total hard currency debt. During the 1960s, US economic aid was given under extremely favorable terms. Annual debt repayments averaged less than $45 million, while aid receipts averaged about $700 million (see Table 1). As US aid declined in the late 1960s, debt repayments increased sharply, and in FY 1972/73[1] Indian aid repayments actually exceeded receipts. Debt repayments are scheduled to increase each year through 1979.

Table 1

India: Aid Receipts from and Debt Repayments to the United States

Million US $

Year[1]	Aid Receipts: Total[2]	Aid Receipts: PL-480	Aid Receipts: Other	Debt Repayments	Net Aid Receipts
1961/62	355	185	170	1	354
1962/63	624	258	366	1	623
1963/64	804	389	415	20	784
1964/65	848	458	390	15	833
1965/66	897	503	394	32	865
1966/67	808	488	320	59	749
1967/68	826	464	362	79	747
1968/69	522	243	279	92	430
1969/70	494	251	243	93	401
1970/71	459	154	305	104	355
1971/72	412	116	296	122	290
1972/73	79	0	79	127	-48

1. Fiscal year beginning 1 April and ending 31 March.
2. Including debt relief.

1. The Indian fiscal year runs from 1 April to 31 March.

US Rupee Holdings

6. In addition to aid repayable in hard currency, the United States sold India about $4 billion[2] in agricultural products under PL-480. Only about 10% was repayable in dollars; the remainder was to be paid in non-convertible rupees. These rupees are deposited in special accounts and cannot be converted to dollars nor generally spent in India without New Delhi's approval.[3] Through mid-1973 the rupee equivalent of about $650 million had been used directly by the United States, $500 million granted to India, about $150 million loaned to US business in India, $1.9 billion loaned to India, and about $75 million granted to Nepal. The remaining $940 million[4] are invested in low-yielding Indian securities that provide potential funds for additional US local expenditures. The outstanding principal and interest on US loans to India, also repayable in rupees over the next 35 to 40 years, would add about $3.7 billion to these holdings. Interest on deposit balances would increase the US rupee holdings even further. Total US claims on India (excluding interest) are about $6.6 billion, as follows:

	Billion US $
Total	**6.56**
Present US rupee balance in India	0.94[1]
Principal due on rupee loans to India	2.32[1,2]
Principal due on hard currency loans	3.30

1. Dollar equivalent of non-convertible loans.
2. Including some dollar loans repayable in rupees.

7. Since US economic aid was suspended in 1971, New Delhi has restricted the use of these rupee holdings to little more than meeting US Embassy operating costs. The United States could continue to use rupees for its own operations in India indefinitely. New Delhi, however, finds this prospect extremely objectionable, and negotiations already are under way to limit such spending.

2. An additional $700 million worth of agricultural commodities was granted to India as emergency relief under PL-480, Title II.
3. Certain specified local expenditures, such as operating costs for the US Embassy, do not require prior approval.
4. Principally because of the addition of interest, total US rupee uses and holdings and Indian dollar repayments add to more than the original $4 billion of PL-480 sales to India.

Trade Versus Aid

8. During the 1960s, when US aid was at its peak, the United States consistently had a trade surplus with India (see Table 2). About four-fifths of US sales to India were financed by economic aid that required the purchase of US goods. When US exports of agricultural products financed by PL-480 increased sharply during the mid-1960s, the trade surplus reached a record high. India paid little attention to increasing its sales abroad, so exports to the United States during this period stagnated.

Table 2

US Trade with India

Million US $

Year[1]	Exports			Imports	Trade Balance	
	Total	Aid Financed	Other		Actual	Excluding Aid
1961/62	491	355	136	245	246	-109
1962/63	662	624	38	246	416	-208
1963/64	945	804	141	273	672	-132
1964/65	1,072	848	224	308	764	-84
1965/66	1,124	897	227	309	815	-82
1966/67	1,044	808	236	292	752	-56
1967/68	1,035	826	209	275	760	-66
1968/69	767	522	245	311	456	-66
1969/70	623	494	129	317	306	-188
1970/71	603	459	144	275	328	-131
1971/72	560	412	148	350	210	-202
1972/73	298	79	219	394	-96	-175

1. Fiscal year beginning 1 April and ending 31 March.

9. US exports to India declined sharply after December 1971, when Washington suspended $87.6 million on previously committed non-project aid. India, however, retained aid in the US pipeline of about $40 million in project assistance and about $35 million in non-project assistance for which letters of credit had already been issued. The interruption of US aid was more than offset by larger commitments from other donors. Subsequently, India has received new economic aid commitments averaging

about $1 billion annually from the Aid-to-India Consortium,[5] compared with an average of about $800 million annually in the previous three years. Even so, net economic aid has continued to decline because of rising debt service.

10. Economic relations between the United States and India remained at a low ebb throughout 1972. Washington did not make any new bilateral economic aid commitments; in fact, there was a net Indian repayment on the US aid account of about $50 million. This made it more difficult for the United States to sell to India, and US exports to India declined about 45% from 1971. India was taking a harder look at imports from the United States, which now had to be paid for with scarce foreign exchange. US imports from India rose 30%, principally because of increased purchases of jute manufactures following disruption of the Bangladesh jute trade by the Indo-Pakistani war. As a result, in 1972 the United States registered its first trade deficit with India in more than a decade. During the first quarter of 1973, with jute exports from Bangladesh partly recovered, US imports from India were 11% lower than a year earlier.

11. Despite the aid cut-off the United States has continued to provide substantial economic assistance to India, largely through international organizations. During FY 1972/73, India received about $200 million in US aid, including:

- $70 million funneled through the IDA, the soft lending arm of the World Bank;
- $53 million in PL-480, Title II (emergency) food relief distributed by US voluntary relief organizations in India;
- $50 million committed before December 1971; and
- $29 million of debt relief in collaboration with other Consortium members.

5. The Consortium includes Austria, Belgium, Canada, Denmark, France, Germany, Italy, Japan, the Netherlands, Norway, Sweden, the United Kingdom, the United States, the World Bank, and the International Development Association (IDA). The Consortium is neither a supranational body whose decisions are binding on its members nor an institution engaging in aid programs of its own. Rather, it provides such expert economic services as analyses and recommendations as well as a forum for mutual consultation and coordination of the aid donors on the one hand and the Indians on the other.

Obstacles to Trade and Investment

12. Comprehensive import licensing and foreign exchange controls cover all of India's foreign purchases. In addition, India's formal tariff structure is relatively high – about 70% of imports are dutiable, and many tariffs are in the 60% to 100% range. India also maintains a long list of embargoed imports. In February 1973, New Delhi expanded the embargo list, imposed higher duties on some items – especially machinery and raw cotton – and increased the share of imports handled directly by government corporations to about two-thirds of total imports.

13. The import licensing system attempts to make maximum use of locally produced goods. It also discriminates among suppliers by giving preference to aid-financed imports and to purchases from countries that do not require hard currency payments. When goods cannot be obtained from domestic sources or from aid donors, buyers are steered to the USSR and Eastern Europe. In part, this move seeks to meet bilateral commitments to expand trade. It also is aimed at bringing Indo-USSR/East European bilateral trade into better balance. The Soviet and East European share of India's import market increased from 3% in 1960 to 11% in 1971. In contrast, the US share of India's market declined sharply from 29% in 1960 to 13% in 1972, reflecting largely the decline in US aid.

14. India is genuinely hostile toward most private foreign investment. The government is committed to reducing the concentration of economic power and the dependence on foreign firms. Widespread nationalization of US and other foreign firms is not likely, however. New Delhi is serious about curbing all private foreign investment that does not (1) earn foreign exchange through exports, (2) save foreign exchange by investment in products leading to import substitution, and/or (3) transfer needed technology to India. Generally, foreign equity must be 40% or less. New Delhi also has controls on foreign equity ownership, licensing arrangements, origin of supplies, use of foreign exchange, choice of imports, and the employment of expatriate technicians and personnel, all of which severely restricts the foreign investor's ability to make major management decisions and to conduct day-to-day operations. In addition, proposed legislation to regulate financing, prices, and profit repatriation and to dilute foreign equity holdings has further depressed the private investment climate.

US Business in India

15. India does not deliberately discriminate against US private investors, although immediately after the US aid was halted in December 1971 there was a temporary administrative tilt against US firms by many Indian officials. Major US private investments are concentrated in the

petroleum refining, pharmaceutical, and rubber tire industries, all of which are subject to government harassment. Such treatment is geared to reduction and perhaps elimination of private participation. For example, new price ceilings on petroleum products do not cover imported crude oil, and thereby could force US-owned refineries to operate at a loss. In addition, royalties for US-provided technology in the tire industry have been reduced sharply. US life insurance companies that were nationalized along with other foreign firms in early 1972 are concerned about the terms and amount of compensation for their assets.

16. According to Indian sources, the book value of US direct private investment is about $150 million[6]; roughly 40% is in the petroleum industry and most of the remainder in manufacturing enterprises. Although India has received less than 2% of US private foreign investment in all developing countries, US firms account for nearly one-fourth of India's private foreign collaboration agreements. More than 400 US firms are involved, of which about 25% are operating under US licensing or technical assistance agreements only. US direct private investment in India increased faster than that of any other country during the 1960s. It is declining now; in 1971 there was a net outflow on India's capital account with the United States of $16 million. The US share is now about 15% of total direct foreign investment in India.

US Trade Policies Toward India

17. US restrictions on imports from India have played a small part in India's poor performance in US markets. Barring a few products such as footwear, most Indian exports enter the US market duty free. The average US tariff on Indian goods is 2.8%. Moreover, the US sugar quota permits India to sell sugar at preferential prices in the US market, and the US textile quota assures India a larger share of the US market than it could obtain competitively against Hong Kong, South Korea, and Taiwan. US imports from India are essentially agricultural commodities (see Table 3). The United States is a major market for these commodities, taking $38 million (46%) of India's exports of edible nuts, $168 million (48%) of its jute products, and $18 million (36%) of its fish in fiscal year 1971/72.

6. US portfolio investment in India, including suppliers' credits, is approximately $225 million. According to the US Department of Commerce, which used a different method of valuation and classification, US direct private investment in India is about $330 million. Unlike India, the United States includes private equity investments if they are at least 10% or more of a foreign firm's ordinary shares. India, on the other hand, counts private foreign equity holdings as direct investment only if the foreign investor has majority control of the Indian company.

Table 3

US Imports from India

Million US $

Commodity	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972
Total	253.5	294.1	309.7	345.3	323.9	297.6	312.2	344.1	298.1	329.2	426.6
Jute manufactures	121.8	151.8	140.7	157.0	160.6	148.0	150.3	169.1	113.0	139.3	218.3
Cotton fabrics	6.8	13.0	11.2	18.7	10.0	10.3	8.4	13.1	11.1	11.2	
Edible nuts	24.0	27.1	31.2	30.7	31.1	30.5	39.2	32.7	37.0	38.1	37.6[1]
Fish and fish preparations	3.9	6.5	5.9	7.4	11.7	11.9	12.9	22.6	18.8	15.0	30.0
Sugar	13.5	14.0	15.5	15.9	8.9	9.2	11.0	8.2	6.4	13.5	18.7
Pearls and precious and semi-precious stones	3.8	3.0	4.0	4.8	6.3	6.4	9.2	9.2	8.0	11.6	26.4[2]
Tea	16.0	15.2	13.5	11.5	10.7	10.4	11.2	8.7	8.0	11.1	16.4
Spices	8.5	3.0	1.6	5.7	5.4	1.7	1.3	1.8	5.3	5.2	
Other	55.2	60.5	86.1	93.6	79.2	69.2	68.7	78.7	90.5	84.2	79.2

1. Including fruits and vegetables.
2. Including all non-metallic mineral manufactures.

Toward a New Economic Relationship

18. There are indications that Indo-US relations are improving from the low ebb of 1972 following the US aid cut-off. The United States is no longer singled out for criticism in public pronouncements. Administrative harassment of US firms is diminishing. Although the previous donor/patron relationship has been reduced, the United States has restored $87.6 million in economic aid that had been halted. India has agreed to US overtures to begin negotiations on the three major economic issues: US rupee holdings in India, future economic aid, and Indo-US trade.

19. In seeking a new economic relationship with India, the United States will face some fundamental obstacles with New Delhi.

- The United States seeks increased private foreign investment in India; New Delhi's hostility to such investment is increasing rather than diminishing.

- The United States seeks increased exports to India; New Delhi's administrative and licensing controls favor purchases from large aid donors, the USSR, and Eastern Europe.

- The United States plans to provide aid only where needed and requested; New Delhi refuses to ask for US aid and has criticized the usefulness of past US aid.

20. The United States and India have begun negotiations on the disposition of the large US rupee holdings in New Delhi generated by sales of PL-480 commodities. India wants to negotiate a large reduction in these holdings because spending them could give the United States some influence over Indian public investment. The United States has proposed a sharp reduction in its holdings, while maintaining adequate funds for its own uses for about 20-25 years. A preliminary favorable Indian reaction gives hope for an early settlement of the issue.

21. The amount of future US aid to India is uncertain. The United States did not pledge new aid to India at this year's mid-June Aid-to-India Consortium meeting in Paris, which pledged $1.1 billion in new aid for India – 20% more than was committed last year. There is a trend toward an improved quality and an increased quantity of aid from many of the other donors. French aid commitments increased 27% under better terms, Germany increased aid by 10%, and Japan by 15%. In addition, Canada, Norway, Sweden, and the United Kingdom indicated the possibility of longer term aid for India.

22. There is a climate of aid weariness in the United States. And it is clear that a resumption of even small amounts of bilateral economic aid to India will depend on requests from New Delhi for aid and a more positive public attitude by New Delhi regarding US aid and US motives. India for its part has not solicited new economic aid from the United States and has agreed to bilateral aid discussions. Although the United States is continuing to ease India's enormous debt burden through the Consortium, Washington seeks to make debt rescheduling contingent on full participation by all Consortium members and an agreement by the USSR and Eastern Europe to provide comparable debt relief. India argues that the US position on debt relief is too stringent and thus far has not sought debt relief from Communist countries.

23. The United States intends to reduce its share of multilateral assistance to India and is questioning its disproportionately large share of IDA financing. The United States has provided about 40% of total IDA credits of about $4 billion, of which about 40% in turn had been extended to India through 31 March 1973. IDA lending to India is now running

at about $400 million annually, with the United States continuing to provide about 40% of these funds. Although the United States continues to make subscriptions to IDA, it proposes reducing that subscription and, along with some other Aid-to-India Consortium members, is seeking to reduce the amount of aid going to India from IDA and to increase that going to other developing countries. IDA's continued ability to make soft loans to India depends on US willingness to continue making contributions to that institution.

24. Of major concern to the United States is export expansion, which is hindered by Indian policy and by India's shortage of foreign exchange. During 1963-71, US exports to India stagnated. During this period, agricultural exports made up 40% to 50% of total sales. Although chemical and transport equipment exports increased about 75%, machinery, non-ferrous metals, and iron and steel manufactures declined about one-third (see Table 4). Chronic Indian agricultural shortages and unique US technology and machinery provide excellent opportunities for expanded US sales. Sales of computers and other advanced technology products, electric power generating equipment, and transport equipment, especially aircraft and railroad equipment, should also increase in any easing of restrictions. However, restoration of US exports to India will depend largely on financing comparable to that of the major aid donors and other commercial suppliers.

25. Despite India's dependence on US food grains, shipments were virtually all made under concessional PL-480 terms, with payment in rupees. These concessional sales, however, did not even assure a preferred position in the Indian market for future US agricultural sales. Only the grave shortage in world grain supplies has driven India to purchase US wheat. To compensate in part for a 10 million metric ton decline in food grain production, New Delhi has imported about 3.5 million tons of food grain, some 2.5 million tons from the United States, and seeks an additional 2.5 million tons. Most of the grain India needs this year will have to be supplied by the United States, if at all. The US grain India needs to import this year will provide the United States with about $700 million in export earnings, if the grain is purchased commercially.

26. India's exports to the United States consist primarily of traditional products which offer little scope for expansion. India has not been able to create a market in the United States for its new manufactured products such as machinery and steel. In the 1960s, jute manufactures accounted for about 50% of imports from India, and cashew kernels about 10%. Other major Indian exports to the United States include fish and fish preparations, precious and semi-precious stones, sugar, tea, and cotton textiles (see Table 3). India is emphasizing increased textile exports to the United States, and in recent Indo-US bilateral textile talks the United States agreed to

Table 4

US Exports to India

Million US $

Commodity	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972
Total	667.46	802.47	947.85	925.89	922.90	950.03	715.21	514.44	571.58	647.31	350.0
Foodgrains	238.87	300.46	427.19	404.06	488.94	392.62	274.52	168.20	159.70	133.93	51.5
Raw cotton	37.17	43.46	37.15	38.84	16.52	53.48	35.21	29.67	36.27	48.68	4.1[1]
Oils and fats	0.29	0.15	0.15	28.24	15.88	57.11	29.02	37.59	50.33	80.36	18.0
Chemicals	34.38	36.40	40.46	62.88	102.61	149.55	147.39	88.79	55.84	65.62	16.5
Iron and steel manufactures	45.20	53.95	47.26	40.10	11.58	14.02	8.57	14.03	48.81	36.76	9.0
Non-ferrous metals	60.04	48.95	44.94	58.94	23.63	22.85	39.52	23.61	37.16	27.73	2.4
Electrical machinery	9.53	41.29	54.27	48.81	34.49	23.00	13.68	10.93	24.72	23.00	20.3
Non-electrical machinery	102.55	130.45	164.08	114.78	123.19	92.57	53.77	38.19	51.71	60.78	50.0
Transport equipment	58.23	53.24	43.22	56.06	29.42	39.30	30.41	15.58	35.04	98.09	79.2
Miscellaneous manufactured goods	4.43	8.00	8.96	11.31	9.80	9.35	7.92	9.07	14.19	15.99	13.2
Other	76.77	86.12	80.17	61.87	66.84	96.18	75.20	78.78	57.81	56.37	85.8

1. Including all textile fibers and their waste.

raise India's textile quota and to exempt handloom products of the cottage industry from quota restrictions. India, however, is seeking an even higher textile quota.

27. Opportunities for substantially increased exports to the United States are limited. Among the principal traditional exports, jute manufactures face stiff and increasing competition from synthetics, textiles and sugar are under quotas, and the demand for tea is growing slowly. Only fish and cashew kernels offer much of an opportunity for expansion. Indian firms prefer selling their engineering products in the more attractive, highly protected home market. At any rate, the sale of such industrial products in the United States and other Western markets would require strict adherence to internationally agreed upon quality standards, competitive prices, and satisfactory delivery schedules that New Delhi has been unwilling or unable to provide.